DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 1759
La Jolla, Calif. 92037

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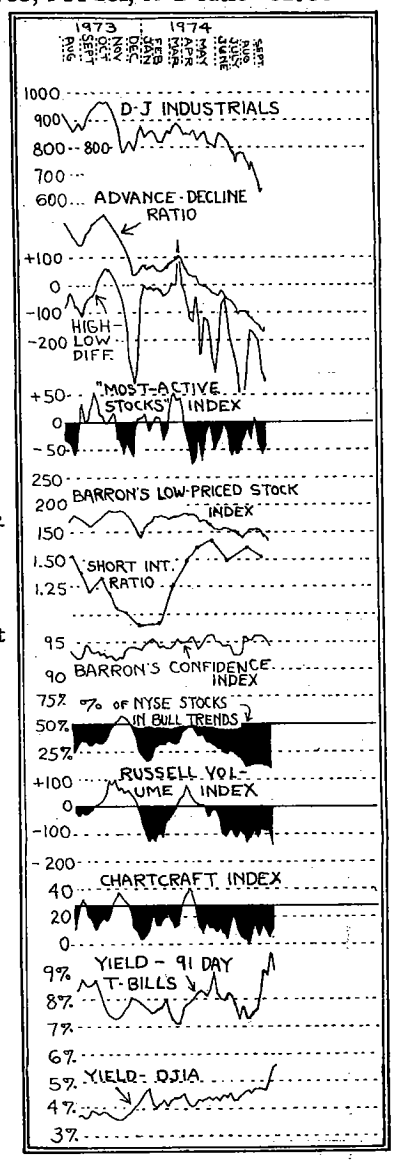
Aug. 23, DJIA 686.60; PTI 276; A-D ratio -31.37
Aug. 29, DJIA 678.58; PTI 251; A-D ratio -32.56



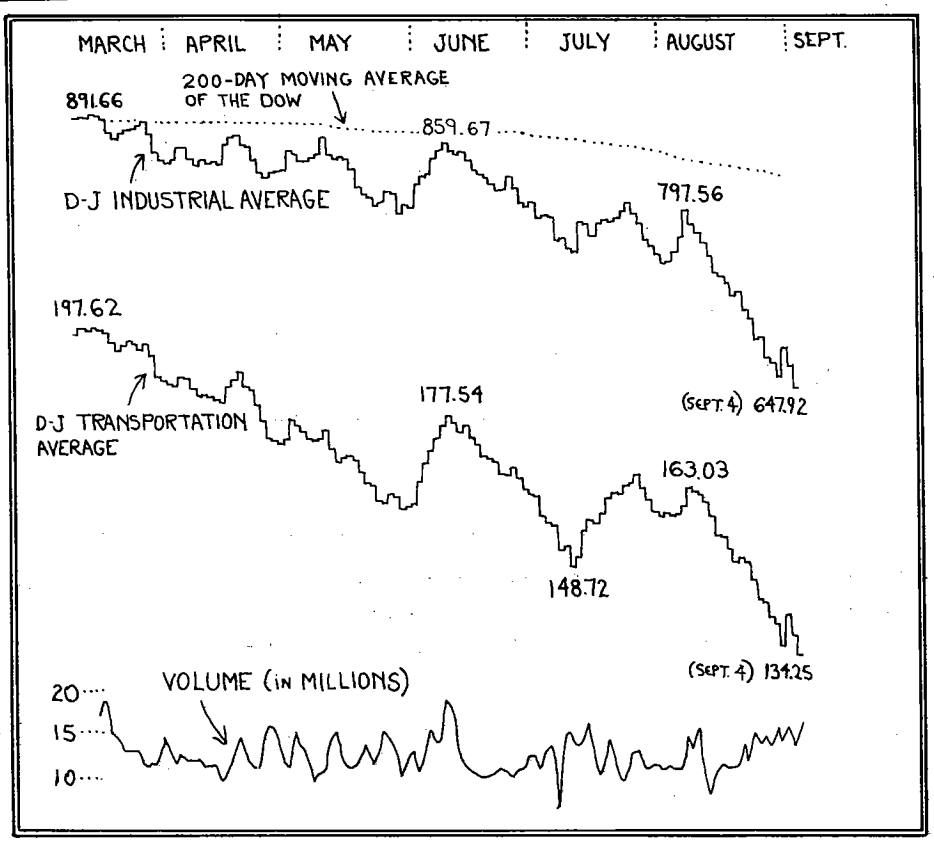
THE BEAR: Politicians never take action until their backs are against the wall. Then, they take as little action as they can get away with. Inflation has the world's politicians against the wall. But the politicians have moved too late. At this stage of the game, the dilemma is hyperinflation or collapse. There is no "soft landing" once the inflation balloon has broken away from its moorings. This is the ominous fact that the politicians don't know — or don't want to know. But Wall Street knows it, and it's protecting itself accordingly, by deflating.

Meanwhile, another great danger is chronic illiquidity in businesses and governments. The symptoms are (1) bank failures, (2) corporate failures, (3) potential government failures. Here I suggest watching Italy and Britain. Both nations are insolvent. Both are poised to collapse. An insolvency of either (particularly Britain, with its important banking system) could set off a world panic.

A third danger is that this primary bear market is going into its late stages, and the bear is beginning to tear at anything which can be ripped loose. This means the possibility of "a shock" from an unexpected place, a shock which could topple what's left of consumer and business confidence. Such a shock could come from the stock market itself, from the Eurodollar market, from a giant bankruptcy, a run on gold, the possibilities are endless, but they are there.

Course of action: Move your assets into gold shares, gold coins, and US Treasury bills. Move out of everything else, and I mean everything. I do not advocate holding silver or silver shares, I do not advocate holding bank certificates of deposit, I do not advocate holding bonds, I do not recommend holding anything but gold shares, gold coins (bullion when legal), and T-bills. That's it.

MARKET: All during 1967-68 and again during the 1970-71 period I warned that the market was



putting on an inflation-inspired show against the primary bear trend (the bear market started in February, 1966). I cautioned that the greater the upside speculation within a bear market, the greater the wrath of the bear when he finally takes over. Lately we have seen some of the bitter fruit of the 1968 and '71 counter-trend speculation. We have seen the bear rising to his full height. We have seen the strength of the bear, one of the greatest and most ferocious bears in Wall Street annals. Day after day, week after week, the bear has been systematically destroying his adversaries, smashing stocks t

 smithereens, crushing the bond market, jarring speculators loose from their margins, pulverizing all who stood in his way. An old timer standing next to me in a boardroom a few weeks ago said, "These young fellers who didn't see 1929 won't have to read about it any longer, they're seeing it all over again right here."

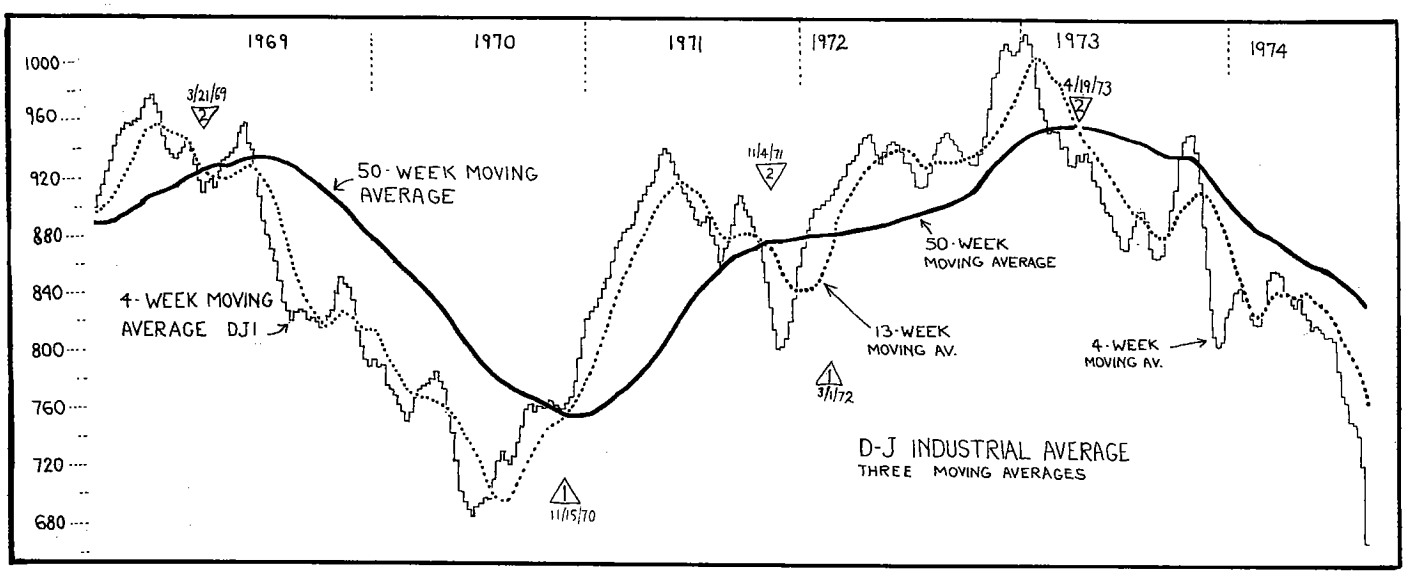
From the 1051.70 peak of January 11, 1973, the D-J Industrial Average dropped on August 28, 1974, to a closing figure of 656.84. This represented a decline of 394.86 points, the greatest pointage drop in Wall Street history (in percentages the drop was 37.5%, a large decline, but not a record).

It was most interesting to study the statistics for the week ending August 30, the week which ended with the Friday rally of 21 Dow points. The figures are particularly interesting because I have never seen a one-day rally greeted with such enthusiasm, such unanimity to the effect that a major bottom had materialized. Actually, I did note that the odd lot shorts were never really impressive on the way down. And at or near the August 28 lows the odd lot shorts were actually pulling in their horns (instead of shorting wildly, as is their usual characteristic at important bottoms). Secondly, the plurality of new lows over new highs for the week ending August 30 amounted to a figure of only -994. This is well below the -1200 (plurality) which I take to represent a downside climax for this indicator (see Letter 603, page 3). By comparison, the week ending May 29, 1970, produced a high-low plurality of -1314 (at that bottom). I would think that the 1974 smash might have produced an even larger minus plurality (since there are more issues listed now than there were in 1970 and since the 1974 decline was worse than 1970 in intensity).

On September 3, with an abruptness that startled even the bears, the market moved down again, closing a whopping 15 Dow points lower at 663.33 (Transports moved down to 137.88). On September 4 the market opened with the Dow off another 15 points, and a feeling of panic began to pervade the air. As this is written (Sept. 4, 11AM NYC time) both Industrials and Transports are at new lows for the move, and the volume is running fairly heavy. There are few times when I have to say this but now is one of them: This market discussion will be continued at the end of the Letter when (hopefully) I know more.

Lest we forget, I want to stress again that in a "benevolent" society such as the one we now live in, everything seems to take much more time. The reason is that the Government fights each new set of circumstances every inch of the way. If deflationary tendencies now develop in the economy (particularly unemployment, which is political) the policy will be more inflation, monetary easing, public works projects, huge military expenditures, rosy economic predictions. That could represent a total reversal of the current inflation-fighting efforts such as tight money, threats of controls, jaw-boning, Presidential scoldings, etc. The cost of these never-ending manipulative policies, unfortunately, could be the market itself, our financial freedom, perhaps in time our political freedom, and in the end maybe democracy as we know it.

It may sound hard-hearted, but I do not know of any society in recorded history which has survived full-fledged, continuing inflation. Many societies (including our own), however, have survived deflation, depression and economic collapse.



MOVING AVERAGES: This is a study which I have presented periodically for many years. It consists of three moving averages of the Dow, a short-term or 4-week MA, an intermediate-term or 13-week MA and a long-term or 50-week MA. It is the nature of these MA's to render valuable "signals," signals which can be most helpful in determining the intermediate and long-term trend of the market.

I term it a market "alert" any time the 4-week MA crosses above or below the 13-week MA. Many traders use these intermediate signals in their trading. My opinion of trading is that it is strictly for professionals. The great majority of averagely intelligent market practitioners lose their shirts when trading over any reasonable length of time.

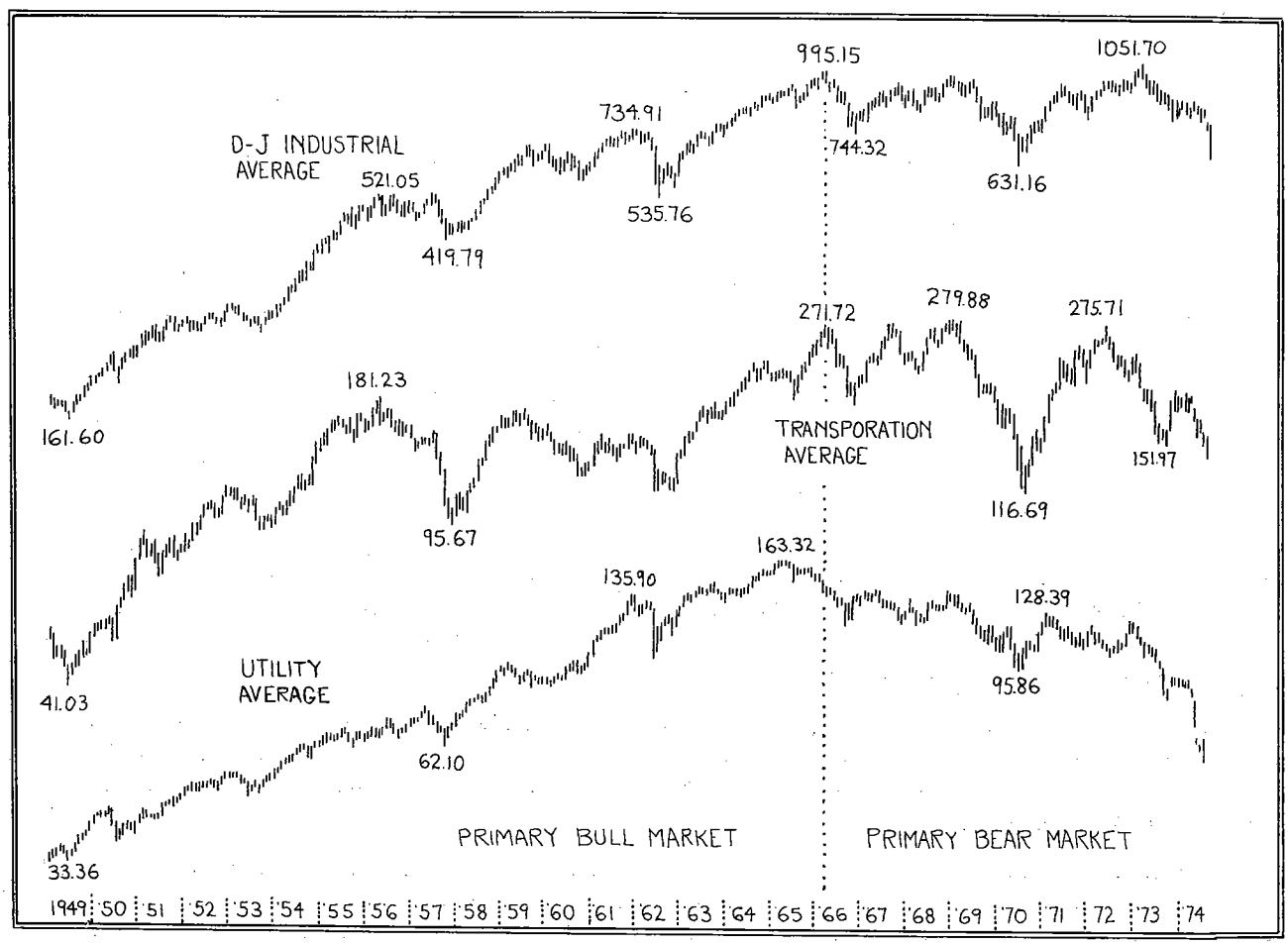
The long-term signals rendered by the MA's are always worth heeding, and I give particular importance to these signals when they occur in the direction of the primary trend. There is one observation which should be understood when using the MA's. Not all long-term signals result in major (or profitable) movements in the direction of the signal (in other words, the signals are not infallible). But all major (and profitable) movements are preceded by long-term signals. In other words, it usually pays to wait for a long-term signal before doing anything. The great, profitable movements consume a good deal of time.

The long-term signals of the MA's are simple enough. Any time the 13-week MA crosses above the 50-week MA you have a bullish signal. These signals are always suspect when they occur during a primary bear market but usually very valid when they occur within a primary bull market. Conversely, when the 13-week MA plunges below the 50-week MA we have a bearish signal. When these signals occur during a bear market, you better believe it (or ignore it at the expense of your bank account).

I have labeled the bullish signals on the chart with a #1, the bearish signals with a #2. Note that there have been only five long-term signals (bull and bear) since 1969. The last signal occurred on April 19, 1973, sixteen months ago. That signal has never been reversed. Thus, this study and the April, 1973, signal would have kept the investor out of the greatest stock market decline since World War II. That was no mean feat, as anyone (who has read the stubbornly bullish advisories and hopeful predictions) knows only too well.

The current status of the 13-week and 50-week MA's is of interest. The 13-week MA has been moving at a rate of about 6.5 points per week. The 50-week MA has been moving at a rate of about 2 points per week. They are now a whopping 69 points apart. This means that if a rally was to occur and the rally was to precede with utter relentlessness, it would take a minimum of 8 weeks for the two MA's to cross, thereby rendering a bullish signal. Actually, since no rise continues week after week without pause, it would require more than eight weeks for a bullish signal. Thus the study of the MA's is telling us that if a major upside movement is now starting (which I doubt), there will be plenty of time before even considering long-term investments.

In the meantime, I suggest that we continue to operate on the assumption that we are near a corrective (upside) phase in a primary bear market. That position has saved us huge potential losses over the past few years, and nothing has occurred since to indicate to me that the bear market which began in 1966 is now over.



PERSPECTIVE: "Well, where are we going?" asks the boardroom wag. "Going," groans one of the harried brokers, "I don't even know where we've been!" It's always good to know where you are in the market. And where you are in the stock market entails knowing where you've been. For this, I find my monthly chart of the three D-J Averages most helpful. This chart last appeared

 in Letter 574, and I am updating it here.

The chart is drawn to ratio scale, which means that the movements of the three Dow components can be correctly compared (all movements on ratio scale appear in percentages so that a rise of 60 to 120 on Utilities, for instance, will take up the exact vertical distance as a rise from 300 to 600 on the Dow).

Note that all during the great primary bull market of 1949 to 1966, it was the Utility Average which led the rise. Again and again, following all secondary corrections, the Utilities proved to be the first of the three Averages to march into new high ground. In other words, it became increasingly apparent that the Utility Averages possessed bellwether or lead characteristics. The action of the Utilities has never been included as part of classical Dow Theory, and this was probably because the Utility Average was first presented during 1929. Charles Dow never saw the Utility Average. William Hamilton (Dow's successor as far as Dow Theory is concerned) died in 1929, and Robert Rhea had only nine years of the Utility statistics (not enough to draw conclusions from) to work with.

Nevertheless, I find the movements of the Utilities well worth watching. Although I prefer not to try to incorporate them into the classic Dow Theory, I continually refer to the Utility movements along with the movements of the D-J 40-Bond Average. Referring to the chart, we see that from the 33.36 low of 1949, Utilities advanced 389% to their 1965 peak of 163.32. On April 20, 1965, the Utilities topped out and turned down; they have been declining ever since. Last week the Utility descent turned into a route, and by August 29 the Utility Average hit a 19 year low of 60.49. This represented a loss of about $120 billion in all listed NYSE Utility shares (the Utility bond losses, of course, have been even more horrendous).

If the Utility Average is to retain its lead characteristics as to the general market, then its recent action must be considered ominous. The Utilities smashed their 1970 bear market low during 1973, and last week the Utility Average plunged below its 1962 low of 62.10. A glance at the chart shows what a comparable decline below the 1962 low would mean for the Industrials and Transports.

I have separated the chart into two broad areas, the primary bull market encompassing 1949 to 1966, and the bear market area including everything from 1966 to date. Note that I have taken February, 1966, to represent the bull market peak, at which time Industrials topped out at 995.15, Transports at 271.72. Although both D-J components rose to subsequent new highs (due to massive inflationary pressures) it is significant that at no time did the two Averages ever record joint highs above the joint peaks of February, 1966. Thus was the Dow Theory vindicated in one of the most difficult "calls" in stock market annals.

In my opinion, it is only a matter of time before the Industrials and Transports follow the lead of the Utilities to new bear market lows (Industrials below 631.16, Transports below 116.69). As I wrote in the last Letter, we are nearing the period where the Government may be reversing gears in preparation for reflation, rather than continuing the current battle against inflation. This may again serve to extend this seemingly interminable bear market, but I expect (regardless of Government manipulation) that this bear market will fully express itself. How long and how painful that process will be, only time will tell.

Here are some significant statistics. The Industrials at their August low of 656.84 erased 44% of its entire bull market rise. The Transports at their August low of 135.87 had wiped out 58% of its whole bull market rise. The Utility Average at August's 60.49 low had wiped out 79% of its entire bull market rise. And the bear market is not yet over.

GOLD: Rumors and facts are now flying like snowflakes in a storm. One fact (from Reuters) is that 10% of all S. African gold is now going into the minting of Krugerrand coins. S. Africa is cutting back on its gold shipments, and supplies of Krugerrands are growing short. In Britain, there is a panicky run on this coin with the premium (over gold value content) now running up to 13%. One dealer says he could sell 10 times the number of Krugerrands he is now allotted.

Englehardt estimates that there will be a demand for 3-5 million ounces of gold per year from the US. A knowledgeable professional and gold expert writes me that he breaks it down as follows: 50 million families in the US of which half are savers. But he feels that a minimum of 5-10 million families will put $1000 each in gold per year. This (at $200 an ounce) adds up to 25 to 50 million ounces of gold taken in by US buyers a year! Or to put it another way, if one out of every 10 Americans bought an ounce of gold, they would take up half the world's annual gold production.

I note that the magazines, advisories and newspapers are still dotted with "sophisticated" stories regarding the wisdom of selling gold before it becomes legal, presumably on January 1, 1975. At that point we are told, everyone is going to rush to take profits. Maybe, but my feeling is that profits will be taken well before January 1, and that the gold market is going to double-cross the financial experts in the daily newspapers.

The above probably is the rationale behind the periodic threats by the US Treasury to the effect that the US will sell gold to keep the price down. Other rumors have it that the US is actually selling gold now, in its effort to keep the gold price down. If true, this should be publicly admitted. It seems intolerable to me that the Treasury would squander the true wealth of the US in an effort to make our currency appear stronger (against gold). Congressman Crane has a bill on docket for Sept. 11 which would halt the sale of US gold without Congressional approval. I suggest that all subscribers write their own Congressmen urging them to support the Crane bill.

Actually, the dollar is now strong against other major currencies. This is partly because of reflation in Europe (to counteract their sagging economies), and it also represents a technical situation, short covering or closing out foreign currency accounts by those who purchased foreign currencies earlier (and who are now losing their shirts as those currencies sink).

It was announced last week that Germany has lent Italy $2 billion to hold that nation together until it can perhaps obtain an EEC loan. Italy, with an inflation rate of 18%, will undoubtedly run through the loan within a matter of months. But what interested me was the terms of the loan. Italy put up one sixth of its gold reserves (which run around $12 billion) to back the loan from Germany!

$2 Billion Loan

BELLAGIO, Italy (AP) — West Germany came to the rescue of Italy's staggering economy yesterday by offering a loan of up to $2 billion.

The agreement was announced after two days of talks here between West German Chancellor Helmut Schmidt and Italian Premier Mariano Rumor.

The two parties agreed it Italy will guarantee the credit with 20 per cent of its $12.8 billion gold reserve. The gold used as a guarantee will be quoted at a price close to the free market quotations — 80 per cent of the average gold price on the London market in August.

The Federal Reserve Board has announced that foreign governments have shipped 3.75 million ounces of gold out of the US since last October. No one knows exactly what this transfer means, but it is clear that the shippers (known to be Saudi Arabia and Switzerland) feel it is safer to have gold out of the US than in it. Do they know something we don't?

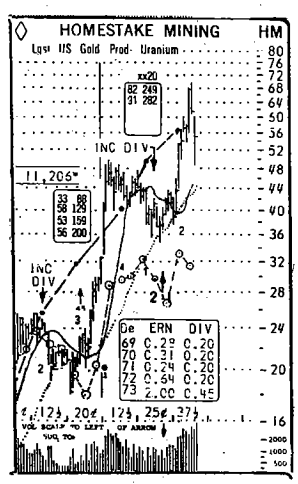
Which brings me to another thought. With the Arabs taking in over a billion a week in oil revenue, I find it totally impossible to believe (as so many would like us to believe) that they are not putting some of that paper money in gold. Put yourself in the Arab situation. Wouldn't you place at least part of that money in gold? It would be insane not to, and the Arabs are not insane. Note also the collapse of the Kissinger-Simon oil policy. Faced with a glut of world oil reserves, the Arabs are not cutting prices, they are cutting output. This may not be good for world economics, but it is patriotic if your are an Arab (they're protecting their assets in the same way that we should be protecting ours).

During the second week of September the IMF is meeting to discuss gold. The IMF is supposed to discuss selling part of its $6 billion of gold to buy World Bank bonds. My feeling is that the IMF, which is "run" by the US, will be taking the usual, negative, jaw-boning position on gold and then wondering how to get the price up as its members see the magnitude of the problem in front of it.

One of the bellwethers of the gold market (I find the Winnipeg gold futures are more often wrong than right) is the US gold coin, the double eagle. This coin has been showing outstanding strength lately. After hitting a low of $233 on July 2 (the coins contain .967 oz. of gold) it ran up on September 2 to just over $300, the first time over $300 since May 13, 1974. The Austrian and Hungarian Coronas, and the Mexican gold pesos are also getting hard to find. I think the heavy buying of gold coins is very bullish for the gold picture.

The financial writers do not see what is happening in this primary bull market in gold. The crucial point is that the American public is finally (but slowly) beginning to understand that gold is real money, that they can turn in their fiat currency (dollars) for gold coins, that at last they have a store of value and that store is legal gold (via coins) or bullion (at the end of the year). They hear the Government saying that gold is going to be legal, it's OK to own it. The great US public is beginning to stir like a giant shaken out of a long, forty-year (since 1934) sleep. The public is finally seeing the gold picture. I say that the advisories don't understand how the public feels regarding monetary inflation, they don't understand how strongly the public will move to protect itself against shrinking dollars, they don't above all understand that "There is no fever like gold fever!"

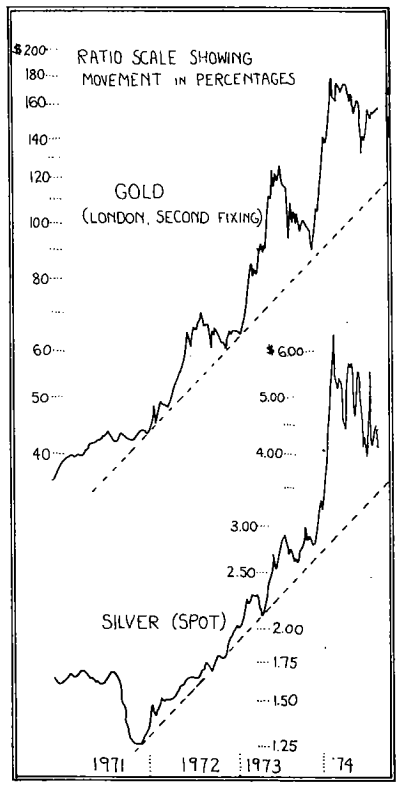
A few weeks ago Alan Abelson, one of the nation's best writers, pooh-poohed Homestake (I am sure that Abelson thought he was doing Barron's readers a service). The stock reacted down to 49 3/4 on the "news" that the bulk of its earnings come from zink and lead (not true today). Homestake is the biggest gold producer this side of S. Africa, and as the price of gold rises Mr. Abelson's figures will be revised. At any rate, alot of shareholders were shaken out of HM. And that's what keeps the gold bull market healthy.



Technically (see chart), HM advanced from 35 in May to 70 in August, a doubling of the price. The halfway point of this rise was 52.5. On the severe August break, which was actually overdue considering the magnitude of the rise, HM dropped to a low closing of 51.5 (it moved intraday below 50 but never closed under 51.5). I would say that this was good action for HM, particularly following the huge volume dumping presumably set off by the Barron's article (chart courtesy Quote Digest, Box 213, Wichita, KS 67201).

HM (I write a good deal about this stock since it is a bellwether for the whole gold share market) has since moved above the 57 level. If HM gets above 60, it will have recouped better than half its August losses, a bullish indication. Therefore, I would consider any closing above 60-61 as very promising from HM, and a harbinger at another try to the 70 high. A HM price over 70 should stir the whole market for gold shares, particularly if a rising trend in gold bullion accompanies the move.

I want to remind readers that during a broad, liquidating market such as the one we have been witnessing during August and September, almost everything that isn't nailed down goes down. Therefore, it is to be expected that people will sell the best to protect the worst. This is one of the reasons gold shares were sold in August, even while everything else was going down. Checking over my charts of the 1920's and '30's I note that Homestake dropped 30% during 1929, then took off during the early 1930's as the price of gold was officially raised. During a hurricane the weakest are washed away and the strongest bend. The gold shares have bent during this crash.



At this point, I would like subscribers to refer to the gold-silver bullion chart. Gold is now showing strength, but silver is beginning to weaken. The trendline for silver comes in at about $3.50 with the current price of silver just under $4.00 per ounce. I take silver as a fairly good barometer of the economic picture. I feel it is a commodity, and it will move with the commodities. If silver breaks $3.50 and gold holds or moves up, my interpretation would be that the economy (and silver use in the industry) is heading for a fall, while monetary inflation (with higher gold prices) will be the "treatment" which the worlds' government will pursue.

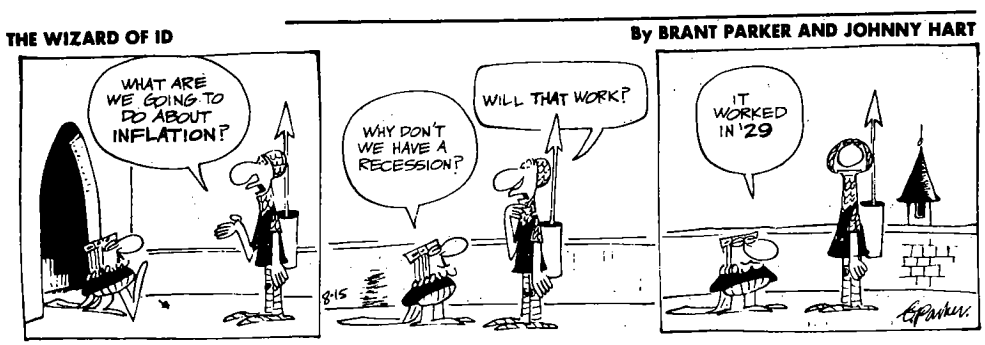
The news clip at the lower right tells a grim story. Whether the Arabs can hold the oil-price line against a world economic cave-in, I doubt. But it is clear that the Saudi's have joined the other Arab nations in holding to high prices rather than "cooperating" with the US and the West. My prognosis — not good.

For those who really believe the US is going to cut expenses, this little clip from Business Week should prove pathetic and prophetic. The only way the US is going to cut expenses is if the economy smashes, tax receipts to the Government collapse, and the money short-falls outrun the Government's ability to inflate.

Ironically, at the same time that Ash is trying to negotiate spending cuts with Congress, two other top economic advisers to the President—Federal Reserve Board Chairman Arthur Burns and Treasury Secretary Simon—are talking about possible additional spending on public service employment. This proposal, which calls for $4-billion or more in new spending if unemployment rose to 6% from the present 5.3% level, would just about offset any budget cuts now being discussed. ■

LATE NOTES: As this is written (near the close, Sept. 4, Wednesday) the stock market can most charitably be described as in a state of disaray. The Dow is down over 15 points, the Transports are down near 4 points and Utilities are down almost a point. This means new lows for the move on all three Averages, confirmed across the board by almost all the technical indicators. It would be an exercise in arrogance or idiocy to pretend to "predict" where this thing is going to stop. Will it halt here, below 631, below 600, who would dare say? But I will say one thing. I believe we are near to winding up the second phase of this bear market, and we are near some bad, some very bad news. When markets go down the way this one is, start looking for the fire. The black smoke is now billowing out of the NYSE, and we'd better look and listen.

I want to stress again that this is one of those times when it would pay to check one's greed and think about just surviving rather than "making a fortune" in the stock market. Before this bear market is over, those with assets are going to be the neighborhood heros, so sit tight, check your urge to play the next bounce, correction or rally. When the real bottom comes, my bet is that it will take a steam-shovel to push the average investor into stocks. We're not there yet. If you have an urge to buy, the odds are it's not the bottom. Bear market bottoms are characterized by an atmosphere of "I wouldn't buy 'em with my worst enemy's money." I repeat, we're not there yet.


THE WIZARD OF ID
By BRANT PARKER AND JOHNNY HART
WHAT ARE WE GOING TO DO ABOUT INFLATION?
WHY DON'T WE HAVE A RECESSION?
WILL THAT WORK?
IT WORKED IN '29
8-15

Arab Refusal to Cut Oil Prices Has U.S. in Bind

Kissinger Had Expected That End of Shortage Would Force Cost Down

BY RICHARD RESTON and PAUL E. STEIGER
Times Staff Writers

WASHINGTON — Early this month two of the world's leading businessmen—J. K. Jamieson, chairman of Exxon Corp., and David E. C. Steel, deputy chairman of British Petroleum Co. — flew quietly into Teheran for an audience with the Shah of Iran.

Their urgent message: At current high prices, oil is backing up in storage tanks all over the world. Western economies are sputtering under the financial strain. The time has come to cut the price of oil.

In years past, the shah and his fellow Middle East oil potentates did the companies' bidding. But not now. There will be no price cut, the shah said. In fact, he suggested, the price might have to be raised further.

The failure of this private diplomatic mission, flashed quickly to embassies around the world, came as no surprise to many Western diplomats. Where oil diplomacy is concerned, they are becoming accustomed to failure.

In the view of many diplomatic experts here and abroad, the delicate U.S. oil strategy of Secretary of State Henry A. Kissinger and Treasury Secretary William E. Simon is in danger of falling apart